

THE MUDDY WATERS OF GLOBAL PROFESSIONAL INDEMNITY

UK and USA-domiciled architectural, engineering and construction firms with offices or projects outside the UK/USA and their territories must contend with a battery of questions about the structure and validity of their professional indemnity and other insurance programs.

Of the world's 245 sovereign nations, 131 maintain membership in the International Association of Insurance Supervisors (IAIS). Many if not most of these maintain their own insurance regulations and requirements.

As any general counsel or risk manager who has dipped a toe into international insurance can testify, the waters can quickly get muddy.

Many firms purchasing Professional Indemnity from a UK or USA-domiciled insurer are likely to have worldwide coverage; i.e. wording in the policy form that will grant cover for projects wherever they are located. The specific terms and conditions of coverage, however, are varied – some policies provide only indemnification in the event of an off-shore claim, some leave defence up to the policyholder and will only reimburse once a judgment is reached, and others will provide coverage only if the demand for damages or suit is brought against the policyholder in the UK or USA.

The presence of global coverage wording often lulls firms into overlooking the implications of the diverse range of local and country-specific insurance requirements. The failure to comply with these requirements may have significant consequences for a firm's balance sheet and its ability to continue its in-country operations. One example: in many countries, local employees who are members of certain professional associations or institutions (e.g. The Royal Institution of Chartered Surveyors in the UK) must have specific coverages.

Additionally, contracts can demand that insurance be placed in a certain manner with certain insurers approved by the employer/principal. For example, the Tender Act in Poland requires public contracting bids to include certain insurance documentation, including a copy of the Professional Indemnity policy; if the carrier is not a registered carrier in Poland, the bid can be thrown out.

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ADMITTED, NON-ADMITTED AND COMPULSORY INSURANCES

In the UK and USA we are familiar with the terms admitted and non-admitted, primarily in the context of access to state insurance funds in the event of a carrier's insolvency as well as filed rates, terms and conditions. Internationally, these structures may have quite different implications and may present significant challenges to firms working outside the UK and USA.

UK and USA-based firms providing professional services internationally are frequently unaware of local insurance regulations and, in particular, requirements that may be enforceable regarding admitted, non-admitted and compulsory insurance. Some jurisdictions also require the broker placing coverage to be licensed in that jurisdiction.

ADMITTED

An admitted policy is issued by an insurance company licensed in the country (or in some cases, state or province) in which the insured maintains an office or in which a project is located. Local admitted policies have a number of benefits: they comply with local insurance regulations, they enable premium tax and claim payments to be made locally, they facilitate allocation of premium for tax purposes, they deliver local certificates of insurance, and, in some cases, they may provide access to local insurance pools and funds. Local admitted policies will also generally track with local legal standards; for example, they may respond to strict or civil liability rather than the usual standard of care that prevails within standard Professional Indemnity policies.

Local admitted policies are typically provided through either a locally placed primary policy or a locally fronted policy that is fully reinsured by the firm's global master policy, usually placed in the firm's home country. Both options pose challenges.

Placing a true local policy may raise such issues as limited in-country capacity, non-concurrency with primary coverage, restrictive terms of local policy forms, limited familiarity with and control over local procurement practices, and limited local market leverage. The only admitted insurers in a particular jurisdiction may be those based in the country – insurers that may not be well known and that may be unrated (or poorly rated).

Relying on a fronting policy can give rise to tax implications and can incur high fronting charges, a lengthy process to finalize reinsurance documentation and fronting agreements, and premium payment warranties (possibly 30-90 days) required on locally allocated premiums.

NON-ADMITTED

In simple terms, a non-admitted policy is one issued by an insurer in a jurisdiction (country, state or province) in which it is not licensed, or is issued in a jurisdiction other than the country in which the risk is domiciled. Many firms use non-admitted paper for their Professional Indemnity insurance and benefit from the flexibility in manuscripting coverage terms and conditions. Internationally, however, the reliance on non-admitted paper in a jurisdiction that requires admitted paper can present a number of issues, including possible penalties and fines for the failure to comply with local laws through the purchase of illegal non-admitted insurance; potential tax liability for repatriating claims payments; potential tax liabilities for failure to pay tax on premium allocated for local activities, in both the current and in prior years; inability to issue valid certificates of insurance; and potential reservation of rights by the UK or USA-based carrier arising out of a failure to comply with local law.

An insurance policy that does not comply with local regulations may be declared void – severely impacting the ability of the insured to recover under the policy as well as affecting licensing and other authorization requirements for the company's in-country operations.

COMPULSORY

A third class of coverage is compulsory insurance, often the result of consumer protection and trade practices legislation. Professional Indemnity coverage for architects and engineers is one of the most frequently mandated compulsory insurances around the world. Some countries prohibit self-insurance for compulsory coverages – a local insurance policy must be purchased.

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FURTHER COMPLICATIONS

TAX

A significant 2001 ruling by the European Court of Justice sets a clear precedent for the local/in-country liability of international firms for the payment of insurance premium tax liabilities within the EU.

Kvaerner plc, a UK-based international firm, purchased a global Professional Indemnity policy from the Lloyd's market to cover all its global operations, including a Dutch entity, John Brown Engineers en Constructors BV, which was held through a wholly owned UK-domiciled subsidiary company. The named insured under the global policy was Kvaerner itself and any of its subsidiaries and affiliates.

Kvaerner's premium costs were internally allocated and invoiced to its various operating entities around the globe. When it became apparent to the Dutch tax authority that the John Brown entity was covered under the master policy, Kvaerner was billed for Dutch premium tax on John Brown's allocated share of the global premium. In **Kvaerner plc v Staatssecretaris van Financiën**, the European Court of Justice ruled that the Dutch tax authorities were indeed entitled to collect this tax. The judges found that the tax was still owed, even when no intra-company payment of pro-rated premium was made.

The obligation to pay premium tax applies to any business operating within the EU, wherever the contract of insurance is entered into or wherever the head office is located.

While the EU generally deems the insurer responsible for the collection and payment of premium taxes, the insurance buyer is responsible for identification of the location of all EU-based risks. As a result of the **Kvaerner** decision, global insurance solutions, which became commonplace in recent years, may now be illegal in some countries.

OTHER JURISDICTIONS

While Kvaerner clearly defined insurance premium tax liability for the EU, other territories are often overlooked.

For example, many USA-based firms practice in Canada and assume that their Canadian exposures are included as part of their US domestic policy – and non-admitted insurance is indeed permitted in Canada. However, all Canadian corporate entities that place insurance with a non-licensed insurer or through a broker outside Canada must pay federal excise tax. Provincial premium taxes may also be applicable. This would also apply to UK-based firms operating in Canada.

Brazil is another example – in this case, of a jurisdiction requiring a local fronting policy because coverage solely through a non-admitted policy is prohibited. A risk located in Brazil may only be insured outside the country if there is no coverage available through the Brazilian domestic market. Entities found placing non-admitted insurance, co-insurance or reinsurance in Brazil or abroad may be subject to penalties equal to the sum insured or reinsured. Other sanctions, ranging from simple warnings to suspension or cancellation of an operating license, may also apply.

Moreover, in Brazil the transfer of monies abroad to pay the premium of non-admitted policies is prohibited. These prohibitions also impact the ability of a Brazilian entity to receive monies in Brazil as a result of indemnification by non-admitted policies.

LICENSED BROKER

Certain jurisdictions around the world require that insurance – admitted or non-admitted, compulsory or otherwise – be placed by an insurance broker licensed in that jurisdiction. This requirement poses further challenges for UK and USA-domiciled firms who must identify and obtain the services of a local broker. Furthermore, buyers must coordinate difference-in-conditions and difference-in-limit issues between the local policy and the global master policy.



WADING IN

Issues associated with global insurance regulation compliance have often been overlooked by UK and USA firms' operating offices or in the delivery of professional services on international projects. The Kvaener ruling was a resounding wake-up call for the London and European markets regarding the consequences of non-compliance – the full impact of which the USA market has not yet fully grasped. As buyers wade into these murky waters, they must be aware of issues they may face.

INTERNATIONAL PROFESSIONAL INDEMNITY ISSUES: A GLOBAL SAMPLING

COUNTRY	NON-ADMITTED POLICIES: ARE THEY ALLOWED?	COMPULSORY INSURANCES: WHICH ARE REQUIRED BY LAW?	TAXES: WHAT TAXES AND CHARGES DOES THE INSURED HAVE TO PAY?	LOCAL ACCESS: IS IT A REQUIREMENT TO USE A LOCAL BROKER?
Armenia	No	None reported	None	No
Azerbaijan	Data not available	Data not available	Data not available	Data not available
Bahrain	No, unless exemption is obtained from Insurance directorate of CBB	None reported	None	No
Georgia	No	None reported	None	No
Iraq	Yes, if at insured's initiative; however, insurers may not solicit business unless locally authorised	None reported	None	No
Israel	Yes, if at insured's initiative; however, insurers may not solicit business unless locally authorised	None reported	None (stamp duty of 1.5% abolished January 2006)	No
Jordan	No	None reported	1% stamp duty, 16% general sales tax	No
Kuwait	Yes	None reported	Supervisor's fee KWD 1.0 per policy	No
Lebanon	Data not available	Data not available	Data not available	Data not available
Oman	No	None reported	0.6% premium tax plus 0.5% emergency fund levy	No
Qatar	Yes	Professional indemnity for consultants working in the energy field, such as architects and technical engineers	None	Brokers may only operate in the Qatar Financial Centre
Saudi Arabia	No	None reported	None	No, but advised for multinational business
Syria	No	None reported	Minimum stamp duty SYP 300 plus stamp duty of 3% of gross premium	No
Turkey	No	Professional indemnity insurance for building site inspectors	Premium tax 5%, guarantee fund levy 2% on obligatory covers for electronic signature certificate providers and private security guards	No
United Arab Emirates	No	Professional indemnity for brokers	None	No
Yemen	Yes, if at insured's initiative; however, insurers may not solicit business unless locally authorised. A new draft insurance law under consideration could change the situation	None reported	None	No

Source: Axco and Lloyd's Crystal databases

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